BEFORE THE STATE BOARD CF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WILLIAM H. GALLITERO)

Appearances:

For Appellant: Archibald M. Mull, Jr., Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of William H. Gallitero to proposed assessments of additional personal income tax in the amounts of $2,589.23, $4,100.53, $4,956.23, $6,643.16 and $6,421.62 for the years 1951, 1952, 1953, 1954 and 1955, respectively.

Appellant was engaged in the coin machine business in San Francisco under the name of Rainbow Novelty. He owned pinball machines, bowlers and some other amusement machines. The equipment was placed in about 20 locations, such as bars and restaurants. The proceeds from each machine, after exclusion of expenses claimed by the location-owner in connection with the operation of the machine, were divided equally between Appellant and the location owner.

The gross income reported in Appellant's returns was the total of amounts he retained from locations. Deductions were taken for depreciation and other business expenses.

Respondent determined that Appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to Section 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code which reads:

> In computing taxable income, no deductions shall be allowed to any taxpayer-on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income

> derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

The evidence indicates that the operating arrangements between Appellant and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, 3 P-H State & Local Tax Serv. Cal. Par. 58145. 5. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is, accordingly, applicable here.

During 1951 and part of 1952, the pinball machines owned by Appellant were exclusively flipper machines, that is, machines equipped with levers which permitted the player to manipulate the ball to some extent after it had been propelled on to the playing field. On August 20, 1952, Appellant first purchased a bingo pinball machine and he subsequently bought more of them. Both types of machines are designed to award free plays to successful players,

Penal Code Section 330b, paragraphs (1) and (2), and Section 330.1 prohibit the possession of a slot machine and define slot machine broadly, in substantially the same language.

Section 330.1 provides, in part:

> Every person who ... owns, stores, . . . possesses, sells, rents . . . any slot machine or device . . . is guilty of a misdemeanor.... A slot machine or device . . . is one . . . that, as a result of the insertion of any ... coin . . . such machine or device . . . may be . . . played, mechanically, electrically, automatically or manually, and by reason of any element of hazard or chance, the user may receive or become entitled to receive any thing of value . . . or the user may secure additional chances or rights to use such machine or device....

Penal Code Section 330b, paragraph (4), and Section 330.5 contain similar exceptions to the definition of "slot machine or device.'? Section 330.5 provides the exception in the following language:

> ... pin ball, and other amusement machines or devices which are predominantly games of skill, whether affording the opportunity of additional chances or free plays or not, are not intended to be and are not included within the term slot machine or device...,

In Appeal of Advance Automatic, this day decided, we concluded that the ownership or possession of a pinball machine is illegal under Penal Code Sections 330b, 330.1 and 330.5 if the machine is predominantly a game of chance or if cash is paid to players for unplayed free games and we held bingo pinball machines to be predominantly games of chance.

Because the application of these Penal Code sections to a flipper pinball machine is not specifically decided in Advance Automatic, the particular features of this kind of a machine should be considered for the purpose of determining whether the operation of the machine involves "any element of hazard or chance" as set forth in Section 330.1, quoted above.

The question of whether the operation of a flipper pinball machine involves chance has not been considered in any reported decision of a California court. The question has, however, been considered by courts in other states.

In White v. State, 35 Ala. App. 617, 51 So. 2d 550 (1951), the Alabama Court of Appeals held a flipper pinball machine to be a game of chance. The court said:

> Respondents insist that the addition of the flippers to this machine renders pure that which was illicit by making the successful operation of the machine depend on skill rather than on chance. It may be conceded that the addition of the flippers probably affords a larger scope for greater degrees of skill in the operation of the machine.
>
> Even so, the trend of the testimony of Appellants own witnesses was that long practice on the machine was necessary to acquire the skill essential to overcome chance.
>
> We do not think that the great mass of the patronizing public has either the time, or inclination, to develop whatever latent talent they may have in this field of endeavor. It would appear therefore that as to the public in general this machine, despite the addition of the flippers, is still a game of chance.

In Baedaro v. Caldwell, 156 Neb. 489, 56 N. W. 2d 706 (1953), the Supreme Court of Nebraska held a flipper pinball machine to be predominantly a game of chance and said:

> It is true that with practice a player may develop some skill which would aid him in bringing about the successful result of obtaining the right to a

> replay; but even with such practiced manipulater the chances of success in the playing of the five balls allotted to him are few and far between, and the opportunity for skill to have any appreciable effect on the result of the play is almost completely overshadowed by the element of chance.

In State v. Paul, 43 N. J. Super. 396, 128 A. 2d 737 (1957) a New Jersey trial court held that chance rather than skill was the predominant factor in the operation of a flipper pinball machine.

In Tinder v. Music Operating, Inc., 237 Ind. 33, 142 N. E. 2d 610 (1957), the Supreme Court of Indiana considered a case involving flipper pinball machines and said:

> In alotterythe winning of a prize is dependent primarily, if not solely, upon chance. In none of said cases was the prize dependent upon the skill or manipulation of the player. This is a significant factor not contemplated in a lottery. However, in the operation of the machines with which this case is concerned, skill is a predominant factor in determining the award of a prize. These machines are equipped with "flippers," by which the player controls the play of each ball. In fact, the conferring of a prize (free play) is improbable unless the player can operate these flippers with a considerable degree of skill, This distinction is recognized in the case of State v. Coats, supra, in which the element of skill did not exist. In that case the court stated: "* * * If any substantial degree of skill or judgment is involved, it is not a lottery. * * *"

It thus appears that three courts have held flipper pinball machines to be predominantly games of chance. In the Tinder case the Indiana Supreme Court held skill to be a predominant factor in operating a flipper pinball machine. However, the implication of Tinder is that chance is at least an element in the operation of such a machine.

Accordingly, we have no hesitancy in concluding that the operation of a flipper pinball machine by a player involves an element of chance and that such a machine is within the definitior of "slot machine or device" in Penal Code Section 330b and Section 330.1 unless it is excepted as an amusement device.

The owners of two locations in which flipper pinball machines owned by Appellant were operated (one throughout the years in question and the other from September, 1951, to

February, 1953) testified that they paid some of the players for unplayed free games. Collection reports prepared by Appellant at the time of the weekly collections and retained in his files indicated that the location owners usually claimed amounts for expenses in each of the years on appeal, amounts so substantial that they can be accounted for only as including payouts for free games. Accordingly, we find that it was the practice to pay players of flipper pinball machines for unplayed free games. Since the flipper pinball machines were not used solely as amusement machines, they were not within the exception of Penal Code Section 330b, paragraph (4) and Section 330.5 and their ownership and possession was illegal under Section 330b and Section 330.1.

In accordance with our decision in Advance Automatic, the ownership and possession of the bingo pinball machines was illegal since they were predominantly games of chance. (See also, 37 Ops. Cal. Atty. Gen. 126.) Moreover, the collection reports previously mentioned indicated that cash was paid to winning players of these machines.

Inasmuch as there was illegal activity, Respondent was correct in applying Section 17297 of the Revenue and Taxation Code

In addition to pinball machines, Appellant owned some bowlers and a few other amusement machines. These machines were in locations where Appellant also had pinball machines. Appellant made collections from and repairs to all machines. We conclude that the legal operation of the bowlers and other amusement machines was associated or connected with the illegal ownership and possession of pinball machines and that Respondent was correct in disallowing all the expenses of the business.

Appellant's records of expenses claimed by the location owners prior to the division of the proceeds were incomplete in that many collection reports were missing. It also appears that Appellant was not entirely consistent in recording such expenses on the collection reports. Respondent, therefore, disregarded the available collection reports and estimated that the expenses constituted 50 percent of the total amount deposited in the machines. Respondent attempts to justify its 50 percent estimate on the basis of the complete records of expenses for 3-1/4 years found in one case in the Fresno area (Appeal of Service Amusements Inc., Cal. St. Bd. of Equal., July 18, 1961, 3 CCH Cal. Tax Cas. Par. 201-774, 2 P-H State & Local Tax Serv. Cal. Par. 13256). However, the actual expense percentage found in the Service Amusements case was slightly under 42 percent.

We believe that the estimate of expenses should be based on the records of the particular taxpayer if such records are available. The pattern of the available collection reports of Appellant is such as to indicate that the unavailable collection

reports were not selectively omitted for the purpose of' leaving only low expense reports. Since the available collection reports are numerous, appear reasonably reliable, and indicate that the expenses were about 30 percent of the total proceeds of all the machines, Respondent's estimate of the expenses must be reduced from 50 percent to 30 percent thereof.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of William H. Gallitero to proposed assessments of additional personal income tax in the amounts of $2,589.23, $4,100.53, $4,956.23, $6,643.16 and $6,421.62 for the years 1951, 1952, 1953, 1954 and 1955, respectively, be modified by recomputing his gross income in accordance with the opinion of the Board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 9th day of October, 1962, by the State Board of Equalization.

Geo. R. Reilly, Chairman

John W. Lynch, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary